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Money and what it's really worth

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“Believe it or not!”, as Ripley would challenge, people are fascinated by crazy ideas.

Americans never run out of ideas!

In February, America would hit the debt ceiling of US\$ 16.4 trillion laid down by the US legislature. The Republicans who lost out the battle against President Obama's efforts to avoid the fiscal cliff are now readying for another round.

So, there is a bizarre, maybe a Democrat idea: mint a trillion-dollar platinum coin to circumvent the debt ceiling.

The idea reminds us of a delightful story by Mark Twain, which was made into a memorable movie by Sir Arthur Rank Production, starring Gregory Peck.

The story goes thus: A penniless Henry gets a million pound note as a gift from two rich brothers, Oliver and Roderick. Henry is unable spend it since no ordinary person would be able to change it. He is also not able to change that note in the bank. On the contrary, he is charged with theft and arrested.

Without knowing, Henry is actually the subject of a bet between Oliver and Roderick: Oliver says a mere possession of a symbol of wealth will enable anyone to have anything he wants, without actually cashing the note. Roderick, on the other hand, feels that the prohibition against exchanging the note for cash will render it totally useless.

Crazy, but clever?

The US law permits the government treasury to mint any coin and give a value, say one trillion. It can then be deposited at the Federal Reserve (the Fed). In turn, the Fed can transfer one trillion bucks to the government for salary payments to its employees, in case it runs out of money in February.

There is a public petition going around with a required minimum number of 25,000 signatures for minting one trillion dollar coin.

The petition makes it clear that it wants to avert the debt ceiling struggle in Congress. The last face-off was in July 2011. It brought down the credit rating of America, followed by a world-wide financial market earthquake.

The petition, which wants to avoid a recurrence, states: "While this may seem like an unnecessarily extreme measure, it is no more absurd than playing political football with the economy."

The Republicans acted fast: One Congressman, Greg Walden hinted that it would introduce a bill to ban government from creating high-value coins to pay its debts.

The idea of minting a platinum coin is political. It is to neutralise the Republican threat that federal employees would not be paid.

If a crazy idea is supported by a Nobel Laureate, Paul Krugman, it attracts attention.

Similar to the maxim, a lie if repeated 1000 times becomes gospel truth. That was in the olden days.

In modern days, in a media free country, stand-up comedians such as Jon Stewart enjoy being "economic experts". They tore the minting idea to pieces.

Jon Stewart joked:

"I say go big or go home- it makes just as much sense to mint a twenty-trillion dollar coin or maybe just 'find' a 'one-hundred quillion-dollar bill', featuring a centaur and a unicorn, as it does to make the trillion-dollar coin."

Funny economists are only embarrassing. If comedians become economists, it is more worrisome!

The impact was quick. The idea was promptly given up.

A Treasury spokesman quietly announced: "Neither the Treasury Department nor the Federal Reserve believes that the law can or should be used to facilitate the production of platinum coins for the purpose of avoiding an increase in the debt limit."

The legislature and executive wings have to work out a practical solution.

Lessons

The episode has lessons for students of monetary economics.

Conservatives fear that government abuses its sovereign power by printing money. The currency is debased by reducing its value, if money supply is increased to fund deficits. However, no government collapses.

The early 20th century German hyper inflation is always fresh in memory. The Fed has a successful experience over fighting inflation in the post-war world.

The latest fear is only from deflation, not inflation!

Further, America is not Greece. It has its own currency with a central bank; and its debt is not in euros. Government can monetise its debt by borrowing from the Fed. The government cannot default. However, how far a central bank would cooperate depends upon its own assessment and the degree of independence it enjoys.

In a free country, no government can make heavy inroads into central bank autonomy.

Finally, money issued by modern governments is fiat or paper money. Money is created simply out of thin air.

Chris Hayes, the American TV host aptly described money as “nothing more than a shared illusion”.

The society accepts it as medium of exchange only on trust. Otherwise we will have a barter economy, which necessitates fulfilment of conditions of double coincidence of wants.

With all its advantages of money, Chris Hayes reminds us:

“The genius of the trillion-dollar coin is that it illustrates the uncomfortable foundational reality of modern capitalism.”

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